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Information reflecting the effects of changing prices

Introduction

At the successive post-war International Congresses of Accountants it has almost become a tradition that a member of the accountancy profession of the Netherlands presents a paper on a subject in the area of 'accounting for the effects of changing prices', invariably including the exposure of and the recommendation to apply the theory and practice of replacement or current value or cost.
It was my compatriot Professor Gijs Bak who - on the occasion of the 2nd Jerusalem Conference on Accountancy in 1974 - offered an international audience a brief resumé of these Dutch congress papers; it seems appropriate to quote his summary in this introductory paragraph:

> 'At the Sixth International Congress (London 1952), *A. Goudeket* presented a paper the essence of which was published in the Journal of Accountancy (October 1952) under the title 'How inflation is being recognized in financial statements in the Netherlands'. In this article Goudeket emphasises the importance of replacement value accounting for the management of an enterprise, especially in a period of inflation.
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> *G. L. Groeneveld,* in a paper prepared for the Seventh International Congress (Amsterdam 1957), dealing with the application of replacement value theory in the 'ascertainment of profit in business', made a strong plea for certainty as to the conception of profit.
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> In a paper presented at the Eighth International Congress (New York 1962), *I. Kleerekoper* analyzed 'The economic approach to accounting'. Here he formulated a series of postulates of accounting, three of which are summarized below because of their significance for the further development of current value theory:
> (1) The transaction result is the difference between net proceeds on goods sold or services rendered and the cost of these goods and services based on (current) replacement value.
> (2) The difference between the amounts paid in the past for the various cost components (historical cost) and the subsequent replacement value used in determining the transaction results must be set aside as 'value differences'. Thus, they do not form part of the transaction results.

(3) The positive value differences set aside in accordance with (1) and (2) appear as capital surplus; negative value differences are debited against the surplus account until it is exhausted. If nominal maintenance of the originally paid-up share capital is aimed at, any further negative value differences are then charged to other surplus accounts and - after they have been exhausted - to the income of the period.

Goudeket, Groeneveld and Kleerekoper all presented comprehensive systems of accounting which entailed unique economic profit concepts based on replacement value theory. *F. Graafstal,* however, in his paper 'Harmonization of accounting principles and the concept of profit' prevented at the Ninth International Congress (Paris 1967), articulated an approach to current value theory which was quite different. Graafstal introduced a concept of profit based on the objective of maintaining the original purchasing power of invested capital. In contrast to Kleerekoper's third postulate, for example, Graafstal concludes that any appraisal adjustment not necessary for maintaining the purchasing power of equity invested is in principle a profit or loss.

Yet another approach, and one worthy of particular notice, at the Tenth International Congress (Sydney 1972) was taken by *W. van Bruinessen.* In his paper 'Bases of accounting other than historical cost' Van Bruinessen does not link income and value in the application of current value, seeing the advantages of current value primarily in terms of the improved quality of information its application generates.'

From the above resumé it will be seen that these authors from the Netherlands have produced at each of five successive Congresses a somewhat conceptual paper, thus trying to convince professional colleagues of all other countries to embrace the replacement value (current cost) basis of accounting. They believed they had good reason for their approach; the world at large had not responded to the problem of changing prices.

The accountants of the Netherlands, with their half century of theoretical and practical experience in the field of accounting methods not based on historical cost, felt themselves justified or even compelled to lead the way and to explain the train of thought behind, as well as the practical implications in applying, these methods. It is difficult to establish to what extent these efforts have contributed to the ultimate setting and keeping in motion of international acknowledgement of the urgency of finding a solution to the problem of accounting for the effects of changing prices. Now that action is being taken worldwide, it seems more useful to present to this Twelfth Congress some overview of the present international state of affairs, than to descend once more into the conceptual depths of the subject. To this end consideration is successively given to:

- International: IAS 6 and 15;
- United Kingdom: SSAP 16;
- United States: FAS 33;
- The Netherlands: TO Directives and Draft-enactment Fourth European Directive.

It is regrettable that within the scope of this paper it was not possible to do justice to the proposals issued within the last few years by many different countries. Therefore it was decided to confine the overview to the above three countries and the International Accounting Standards Committee's initiatives.
The paper concludes with some comparative reflections.

International: IAS 6 and 15

The International Accounting Standards Committee (IASC) finds itself in a difficult position in dealing with a subject that is internationally still in a very early and unbalanced stage of development. In such a situation the Committee's usual approach of first cataloguing, then testing and in the end harmonizing the varying practices of different countries cannot be applied. Against this background it would not have been surprising if the IASC had decided to drop the subject of 'Inflation accounting' or, better formulated, 'Accounting for the effects of changing prices', at least for the time being. Instead, it took the course of trying to stimulate international interest by publishing on 1 March 1977 a discussion paper, entitled 'Treatment of changing prices in financial statements; a summary of proposals', followed in June 1977 by a very basic standard, IAS 6, named 'Accounting responses to changing prices'.

This standard states that enterprises should present in their financial statements information that describes the procedures adopted to reflect the impact on the financial statements of either specific price changes, or changes in the general level of prices, or both. If no such procedures have been adopted, that fact should be disclosed.

Whether IAS 6 has really stimulated national developments is not easy to ascertain. It is, however, true that since 1977 a tremendous amount of work has been invested, with positive results, in the standardsetting process concerning the changing prices issue. Reference can be made to the successive, but not always similar, drafts and standards in the United Kingdom, the United States, Australia, Canada and South Africa; the Fourth European Directive and its consequences should also be mentioned. These developments encouraged the IASC to take a modest step forward; in August 1980 it issued the exposure draft E 17 to be followed in November 1981 by IAS 15 'Information reflecting the effects of changing prices'.
IAS 15 makes it clear that it is still too early to require enterprises to furnish this information by preparing primary financial statements in which a comprehensive and uniform system for reflecting changing prices

is used. 'Meanwhile, evolution of the subject would be assisted if enterprises that present primary financial statements on the historical cost basis also provide supplementary information reflecting the effects of price changes'. It is desirable that an internationally established minimum of items is included therein.
This minimum, to be found in IAS 15:

- is based on 'an accounting method reflecting the effects of changing prices; this wording leaves room for current cost as well as general purchasing power methods and also to a combination of both (nevertheless it is evident from the 'Explanation' that a preference exists for current cost);
- includes at least (in other words, a minimum within a minimum) the adjustment to or the adjusted amount of depreciation (of property, plant and equipment) and of cost of sales;
- includes further, 'when such adjustments have been taken into account in determining income under the accounting method adopted', one or more adjustments relating to monetary items; this wording implies that enterprises remain free not to apply any of these adjustments; however, if such an adjustment is contemplated, it should fit in with the accounting 'method' and therefore requires consistency; the following adjustments are mentioned in the 'Explanation':
  a. adjustment on all net monetary items (see FAS 33);
  b. adjustment on monetary assets and liabilities included in the working capital (see SSAP 16);
  c. the gearing adjustment (see SSAP 16);
  d. adjustment by a general price level index applied to the amount of shareholders' interests;
- includes the enterprise's recomputed results on the basis of the aforementioned items and of any other items reflecting the effects of changing prices that are reported under the accounting method adopted; here again the wording leaves room for freedom, firstly in choosing a suitable definition for the concept of 'results' (necessary with regard to the British and American standards), secondly in furnishing additional information (such as the tax effects of current cost adjustments) in which case it should be included in the recomputation of the results;
- includes the disclosure of the current cost of property, plant and equipment and of inventories, when a current cost method is adopted;
- includes lastly a description of the methods adopted to compute the different adjustments and the recomputed results, including the nature of any indices used.

Generally speaking, IAS 15 is a standard that has been designed to bring about the presentation of information on the impact of changing prices, at least concerning depreciation and cost of sales, encouraging the development of more comprehensive methods.

United Kingdom:
Statement of Standard Accounting Practice No 16 (SSAP 16)

In March 1980 this British standard was issued under the title 'Current Cost Accounting'. Its starting point is that the 'net operating assets' - consisting of fixed assets, stock and monetary working capital - can be said to represent 'the operating capability' of the business. Successive price changes affect the amount of funds required to maintain this operating capability. Only current cost accounts are - in contrast to historical cost accounts - designed to reflect this phenomenon in the determination of profit and in the balance sheet.

Consequently, the standard requires that 'annual financial statements of entities coming within the scope of the Standard should include, in addition to historical cost accounts or historical cost information, current cost accounts prepared in accordance with this Standard'.
The wording of this requirement implies that the entity is free to choose between current cost and historical cost for the presentation of its main accounts; the choice of the one for its main accounts leads automatically to the use of the other for its supplementary accounts. However, the Standard remarkably allows the presentation of current cost accounts as the entity's only accounts (an option that is not permitted for historical cost accounts) and supplementary 'full historical cost accounts' are not required; only 'adequate historical cost information' will in this case suffice. For the contents of this 'adequate' information reference is made to the coming UK enactment in connection with the adaptation of UK Company Law to the EEC Fourth Directive. The alternatives offered by the Standard seem to aim at the general acceptance of current cost accounts as the main or even only accounts; notwithstanding this implicit aim, the standard otherwise follows the more realistic course of requiring entities to present their main accounts on the basis of historical cost, accompanied by supplementary current cost accounts containing a profit and loss account, a balance sheet and the corresponding explanatory notes.

The paragraph on 'the current cost profit and loss account' takes the 'historical cost trading profit' as the point of departure and then requires a number of adjustments in order to arrive at the 'current cost operating profit' and the 'current cost profit attributable to shareholders'. A fact is that this determination of the profit for an accounting period requires a two stage approach. The first stage includes the surplus arising from the ordinary activities of the business, after allowing for the impact of price changes on the funds needed to continue those activities and to maintain its operating capability, but without taking into account the way in which it is financed; interest on net borrowing and taxation are therefore not included in this stage which may be considered as the stage of the determination of 'current cost operating profit'. In the second stage the way in which the business is financed is taken into account; this is done

by establishing the extent to which the net operating assets are financed by borrowing and then taking this proportion as a basis for the 'gearing adjustment' which results in a proportional reversal of the amounts set aside in the first stage; this reversal finds its justification in that liabilities for repayment of borrowings are normally fixed in monetary amounts so that borrowers have no claim on such additional funds; what remains after the reversal is the amount of funds needed to maintain the shareholders' proportion of the operating capability of the business. This 'current cost profit attributable to shareholders' is shown after interest, taxation and extraordinary items.

Besides this two-stage profit and loss account, the required presentation includes a balance sheet showing the assets of the entity 'at their value to the business, based on current price levels', thus enabling a realistic relationship to be established between the current cost profit and the net assets employed.

So much for the background of SSAP 16, taken from its Explanatory Note. In elaborating this background, the concept of 'value to the business' appears to play such an important role that attention should be given to its contents here and now. The definition of 'value to the business' is: 'net current replacement cost or, if a permanent diminution to below net current replacement cost has been recognised, recoverable amount', the latter being the greater of net realisable value and amount recoverable from further use.

The determination of profit in the current cost accounts is made as follows:

- point of departure : the historical cost trading profit, before interest on net borrowing and taxation;
- adjustment no 1 : to depreciation on fixed assets, the difference between their value to the business and their historical cost consumed in the period;
- adjustment no 2 : to cost of sales, the difference between the value to the business and the historical cost of stock consumed;
- adjustment no 3 : based on monetary working capital, an adjustment proportional to that shown under 2, but now applied to working capital in so far as it consists of monetary items (being mostly only trade debtors minus trade creditors), in order to show the effects of changing prices on the total working capital and not only on its stock element;
- sub total : current cost operating profit;
- adjustment no 4 : the gearing adjustment, being the partial reversal of adjustments 1 - 3, in the proportion of net borrowing to net operating assets;

- interest on net borrowing;
- taxation;
- extraordinary items;
- final total : current cost profit attributable to shareholders.

The matching current cost balance sheet may be presented in summarized form when a full historical cost balance sheet is disclosed; the fixed assets and stocks should be shown therein at their 'value to the business', as defined before; the revaluation surpluses on fixed assets and stocks as well as the total of the four current cost profit adjustments should be included in the 'current cost reserve'. Notes to the balance sheet should disclose the totals of net operating assets and net borrowing and their main elements.

The foregoing summary of the determination of profit and financial position in 'current cost accounts' can be completed by the following notes:

- the 'value to the business' of an asset is the lower of its replacement cost or recoverable amount; the test for switching to the recoverable amount lies in the recognition of a 'permanent diminution' to below net current replacement cost, which applies to fixed assets as well as to stocks;
- usually the monetary working capital includes only trade debtors and creditors; this implies that the m.w.c. adjustment may sometimes be negative (if the amount of creditors exceeds that of debtors);
- it is sometimes necessary to include cash or overdraft in monetary working capital, whenever fluctuations in the volume of stock, debtors and creditors lead to contrary fluctuations in cash or overdraft; this statement sounds rather vague and could result in arbitrary decisions;
- it is permitted to combine stocks and m.w.c. under one heading 'working capital'; the same applies to the related adjustment;
- it is explicitly stated that the 'gearing adjustment' is retrospective in that it arises wholly because of the manner in which net operating assets are financed in the period; its inclusion in current cost profit is therefore not dependent on the future ability to refinance these assets similarly; this statement is at the least remarkable;
- recognising existing differences of opinion thereon, the Standard nevertheless maintains the defined method of calculating the gearing adjustment; the effect of different methods can additionally be disclosed in the notes;
- the objective of the Standard is clearly the maintenance of the entity's operating capability in two stages; in the first stage for the business as a whole; in the second stage for the shareholders' portion only;
- the Standard sets out basic principles, but does not set out to prescribe the methods to be used in the preparation of current cost accounts; only Guidance Notes have been published and consequently the Standard requires that the notes to the current cost accounts describe the bases and methods adopted;

- listed companies are required to show earnings per share based on the current cost profit attributable to shareholders before extraordinary items;
- when current cost group accounts are produced there is no requirement for c.c. accounts for the parent company alone.

United States;
Statement of Financial Accounting Standards no 33 (FAS 33)

Under the title 'Financial Reporting and Changing Prices' the above mentioned statement was published in September 1979 by the F.A.S.B. (Financial Accounting Standards Board). Its starting-point is that 'many people believe' that the users of financial statements need information about measurements in units of constant general purchasing power, whereas again 'many people believe' that financial statements based on historical cost fail to provide sufficient information in not identifying separately changes in prices of assets held. The Standard therefore requires certain public enterprises that prepare their primary financial statements on a historical cost basis to disclose supplementary information in units of constant general purchasing power as well as information based on the current cost of inventory and property, plant and equipment. It is believed that further experimentation will provide a basis for judging the usefulness of the required information and for deciding more definitively on the methods and techniques to be applied.

The Standard requires the supplementary information to include:

a. 'income from continuing operations' - being income after applicable income taxes but excluding the results of discontinued operations, extraordinary items, and the cumulative effect of accounting changes - on a historical cost basis but expressed in units of constant general purchasing power and also the separate disclosure of the inflation gain or loss on net monetary items;
b 'income from continuing operations' on a current cost basis, and also the separate disclosure of the current cost amounts of inventory and property, plant and equipment and of their increases or decreases for the current period, net of inflation;
c a five-year summary, including such information as: net sales; income from continuing operations (in total and per share), and also net assets at year-end, all these amounts computed on the basis of a. as well as b.; cash dividends and market price per common share; disclosure of the level of the price index used for each of the five years.

With regard to the preparation of this supplementary information some additional details for each of the three categories are mentioned below.

a. Information on the basis of constant purchasing power:
   - the Consumer Price Index shall be used;
   - a restatement shall be made of inventory, property, plant and equipment, cost of goods sold, depreciation, depletion and

amortization expense, and also of any reductions of historical cost amounts to lower recoverable amounts;
- the restatement shall be based on the average level of the price index for the fiscal year.

b. Information on the basis of current cost:
- inventories and (the remaining service potential of) property, plant and equipment shall be measured at current cost or lower recoverable amount at measurement date;
- cost of goods sold shall be measured at current cost or lower recoverable amount at the date of sale;
- depreciation and amortization shall be measured on the basis of the average current cost or lower recoverable amount of the assets' service potential during the period of use;
- the amount of income tax expense shall be the same as the amount charged to the historical cost financial statements (this implies that it is not permitted to show the tax-effects of the current cost recomputations);
- the increases or decreases in the current cost amounts of inventory and property, plant and equipment (from the beginning of the year or its later date of acquisition till the end of the year or its earlier dates of use or sale) shall be reported both before and after eliminating the effects of general inflation;
- various types of information may be used to determine current cost, such as externally of internally generated price indices for the class of goods measured, as well as direct or specific prices derived from invoices, price lists, standard costs etc.;
- the recoverable amount of an asset shall only be used if it is judged to be 'materially and permanently lower' than its current cost; decisions need not to be made considering assets individually unless used independently of other assets.

c. The five-year summary:
the information presented in this summary should be expressed in constant purchasing power, which implies that the figures of every separate year, each time they are used again in a subsequent five-year summary, should be re-indexed in order to adjust them to the purchasing power level of the current year.

In an appendix to the Standard, illustrations of two different formats are given for the presentation of the information required under a. and b. The first format shows a vertical statement beginning with income from continuing operations, as reported in the primary income statement and therefore on a historical cost basis; this income amount is then subject to an adjustment to restate cost of goods sold and depreciation expense to reflect the effects of general inflation; the resulting balance is then adjusted again to reflect the difference between general inflation and changes in specific prices of cost of goods sold and depreciation expense, thus arriving at income on a current cost basis. The second format shows a horizontal three columns statement, each column showing an end total

of income from continuing operations, respectively on a historical cost, constant general purchasing power, and current cost basis.
In both formats income from continuing operations is followed by:
- inflation gain or loss on net amounts owed;
- increase in current cost of inventory and property, plant and equipment during the year as compared with the effect of increase in general price level.

The Netherlands: Directives of the Tripartite Accounting Standards Committee and Draft-Enactment Adaptation to Fourth European Directive.

The Netherlands' 'Act on the Annual Accounts of Enterprises' (now included in the Civil Code, Book 2, Title 6) does not prescribe a specific basis of valuation. In section 5 (art. 311) it only says: 'The basis underlying the valuation of the assets and liabilities and the determination of the results comply with standards that are regarded as being acceptable in economic and social life'.
During the course of Parliamentary review and debate, the Minister of Justice indicated that he wanted business and labour as well as the professional body of accountants to conduct a joint effort in first cataloguing and then evaluating the acceptability of existing accounting policies. As a result a joint committee was set up in 1971, composed of representatives of the Employers' Associations, the Trade Unions and the Institute of Registeraccountants (NIVRA); this joint committee is generally referred to as the 'Tripartiete Overleg' (T.O.) which is freely translated as 'Tripartite Accounting Standards Committee'.
In its 'Directives for Annual Financial Statements' of June 1980, chapter 1.03, the TO lays down that, with regard to fixed assets and stocks (inventories), financial statements should include information about the enterprise's results and financial position on both an actual value and a historical cost basis. It leaves undetermined the question as to which basis should be chosen for the primary accounts and which basis for the supplementary information; it does, however, require consistency, both simultaneously as well as successively. This requirement implies the application of the same basis (actual value or historical cost) for balance sheet measurement and determination of profit.

The term 'actual value' has more or less the same meaning as the U.K.'s 'value to the business'; under normal conditions it is current replacement cost; however, if the replacement of fixed assets or stocks is not any more envisaged because of discontinuation of activities, the actual value of these assets must be their recoverable amounts. Moreover, for stocks there is an additional overriding requirement for valuation at net recoverable amounts if less than bookvalue on a historical or replacement cost basis. It is expressly clarified that the existence of a loss situation should not automatically lead to the abandonment of the replacement

cost basis; on the contrary, it is emphasized that in such a situation the continuation of the enterprise's activities for an indefinite period of time makes it necessary to maintain the replacement cost basis, this being the only basis that correctly measures the size of the losses caused by such continuation. A downward revaluation should only be made after a decision to terminate an activity. In case of a short term liquidation the fixed assets should be valued at their directly recoverable amounts; in case of termination after a somewhat longer period of time valuation should take place at net indirectly realisable value.

Chapter 2.02 on 'Fixed assets and depreciation' and 2.03 on 'Inventories and cost of goods sold or consumed' further suggests that:

- replacement cost should be determined primarily on the basis of specific price information and only in the last resort by the use of indices prepared by industrial organisations or statistical institutions;
- in case of replacement of non-identical fixed assets their price development should be revised for the effects of technological progress;
- the cost of goods sold or consumed could be approximated by using the lifo or base stock method; however, these methods are not acceptable for balance sheet purposes so that in such cases a different method for the determination of the actual value of inventories should be applied.

In the meantime, important changes are expected in this field as a result of the adaptation of the Dutch Civil Code to the Fourth European Directive on Company Accounts. With regard to the valuation of assets, this Directive (which was originally published in draft in November 1971 and finally adopted on 25th July 1978) contains the general rule that the historical cost basis should be used (art. 32), assets being included in financial statements at amounts based on their purchase price or production cost, but authorises Member States to permit or require the following alternatives (art. 33):

a. replacement cost accounting for fixed assets and stocks;
b. valuation of all items in the financial statements, including stockholders' equity, by any other method that is 'designed to take account of inflation';
c. revaluation of fixed assets.

A draft-Enactment for the adaptation of the Civil Code to the Fourth Directive is now (Spring 1981) in the hands of Parliament. From this draft-Bill and the accompanying explanatory notes the following important matters arise:

- the valuation of assets and the determination of profit may be based either on historical cost or actual value;
- this free choice is not an unlimited one; if an asset is shown in the financial statements at an amount that is considerably less than its actual value, the explanatory notes should give supplementary

information; however, a restatement of the asset to its actual value is *required* if, notwithstanding the aforementioned supplementary information, the possibility of forming a sound judgement on the enterprise's financial position and results would be significantly affected. The borderline between the requirements to give supplementary information or to restate the asset cannot be generally defined and any specific decision remains in the hands of management. The auditor judges the acceptability of this decision;
- enterprises have at all time *the right* to restate their fixed assets and stocks (inventories) at actual values;
- further details concerning the methods of revaluation will be given by governmental resolution. There is no intention to include therein the possibility of applying the general purchasing power method of inflation accounting, as meant in art. 33, par. 1 under b. of the Fourth Directive, the argument being that g.p.p. accounting cannot be defined as a method of valuation of assets and liabilities;
- only sound reasons permit to change the accounting basis applied in the previous financial statements; disclosure of reasons for change and their impact on financial position and results is then required;
- the difference between the book values of an asset before and after a revaluation should be taken to a 'revaluation reserve'; this revaluation reserve should appear in the balance sheet as a separate item and should be segmented by the nature of the revalued assets;
- the revaluation reserve can be transformed into capital; it is not permitted to transform revaluation amounts into profit or to add them to free reserves;
- the revaluation reserve should be decreased to the extent that it is no longer appropriate either to the valuation basis selected (for instance: when changing from actual value to historical cost) or for the purpose of revaluation (for instance: when the activities for which the asset is in use are definitively discontinued). The decrease of the revaluation reserve should only be distributed to shareholders or taken into profit to the extent that the corresponding assets have already been charged to the profit and loss account in the form of depreciation or cost of goods sold, or have in the meantime been disposed of;
- the explanatory notes should disclose whether and, if so, how the tax implications of revaluation have been accounted for; no guidance is given.

It seems useful to once again draw the attention of the reader to the fact that at the time of preparing this paper neither the Directives of the TO nor the Enactment Fourth European Directive have reached a definitive status. However, it may not be too unrealistic to assume that the definitive regulations will not differ too much from their drafts.

Some comparative reflections

From the discussion it has become evident that the various accounting

methods described therein may show several points of agreement, but also demonstrate quite a number of points of difference. It would go far beyond the scope of this paper to sum up and compare all these points; only some of the more important ones are briefly considered here.

It is only in the United States that, in the context of accounting for the effects of changing prices, the standard setting authority could not arrive at a choice between the presentation of (supplementary) information on a current cost basis and information on the basis of historical cost expressed in units of constant general purchasing power. It is also true that the IASC did not really make a choice, in that it leaves open the option to select one of the two above mentioned methods (somewhat hesintatingly, particularly in order to accommodate the US). Only the United States require in FAS 33 the presentation of three different income computations in a vertical or horizontal format, consisting of the primary figures in historical prices, supplementary figures in historical prices expressed in constant dollars and supplementary figures in current prices. In the UK and in the Netherlands recent statements make no reference at all to a requirement to present g.p.p. information; both countries settled on the requirement to apply current cost accounting along with historical cost figures.

FAS 33 gives emphasis to the need for experimentation. It says: 'It seems unlikely that a consensus can be reached until further experience has been gained with the use of both types of information in systematic practical applications. This statement therefore requires ... to present information both on a constant dollar basis and on a current cost basis'. This quotation contains a somewhat remarkable train of thought. It is difficult to see how the systematic practical application of two (or in fact three) different accounting bases side by side can possibly give a sound answer to the question as to which basis should ultimately be selected as the best one. It seems evident that a mere comparison of their respective outcomes cannot assist in arriving at the aforementioned answer. This conclusion does not change by increasing the number of comparisons. Only deductive reasoning may lead the way to a solution of the American dilemma.

The United Kingdom's standard gives enterprises the option to present their primary financial statements on a current cost basis - and consequently the supplementary information on a historical cost basis - but the remainder of SSAP 16 is based on the realistic assumption that the historical cost figures are the point of departure for the required recomputation of results and financial position on a current cost basis. In the Netherlands the TO does not express any preference regarding the use of the one or the other cost basis in the primary or supplementary information; the main point is that both current cost and historical cost information must be presented. However, the draft-Enactment Fourth Directive seems to severely impede this free option; under certain

circumstances it even imposes an obligation to revalue one or more assets, which means that it is not beyond possibility that a single asset may qualify for the revaluation requirement. This rather exceptional proposal is widely criticised in the Netherlands and it is to be hoped that it will not reappear in the definitive Act.

It is important to observe that only SSAP 16 requires the recomputation - be it in two stages - of the full profit and loss account down to the bottom-line net profit. This is certainly not the case in FAS 33 which purposely limits the recomputation to the 'income from continuing operations'. The IASC requires 'recomputed results' but abstains from defining this concept, thus leaving room for both approaches. In the Netherlands the TO says the information should permit a sound judgement to be formed on the amount and composition of the results on an actual value basis; the draft-Enactment Fourth Directive is less conclusive in this respect; it is therefore reasonable to expect the TO's view to remain decisive.

SSAP 16 has undoubtedly some special features in requiring, along with the adjustments of depreciation and cost of sales, the 'monetary working capital adjustment' and in addition the 'gearing adjustment'. It is true that FAS 33 requires the calculation of the inflation gain or loss on 'net monetary items', but only in the context of constant dollar information and without inclusion in income. The IASC permits the application of all the aforementioned adjustments. In the Netherlands these adjustments are not required nor recommended.

Both additional adjustments of SSAP 16 are of a controversial nature, nationally as well as internationally. In no way is it generally considered to be a logical step to apply consecutive price differences of non-monetary assets to 'monetary working capital'. It is even less widely accepted to use the way in which the business is financed as a basis for including or not including these consecutive price differences in profit. Particularly the last mentioned procedure - the application of the gearing adjustment - is often upheld by urging the necessity of *not only* allowing for the impact of price changes on the funds needed to continue the existing business as a whole (i.e. to maintain its operating capability as a whole), *but also,* separately and ultimately, only the shareholders' proportion therein.

It is widely accepted nowadays that the enterprise has primarily a social function. This means that the existing and potential interests of employees, customers, trade creditors, the government and the public at large should be considered to be of at least equal importance as the interest of shareholders. In this context financial statements giving general purpose information should be drawn up in such a way as to show the financial position and the results of the business as a whole. Those who hold this view reject the application of a gearing adjustment. But apart from the foregoing objections, it is remarkable that the gearing adjustment leads to the situation that enterprises with a comparatively weak financing structure are in a position to present much higher profits

than their stronger competitors. This situation becomes worse by SSAP 16's rule that inclusion of the gearing adjustment in profit should *not* be made dependent on the future ability to refinance assets similarly.

SSAP 16 as well as FAS 33 contain the requirement that, in the recomputation of the results (or income, or profit) on a current cost basis, the amount of income tax expense shall be the same as the amount charged to the historical cost income statement (or profit and loss account). The IASC leaves all options open. In the Netherlands the situation is different; the draft-Enactment Fourth Directive requires the disclosure in the financial statements of whether and, if so, how the tax implications of the revaluation of assets have been accounted for.

Finally it is worth noting that both SSAP 16 and FASS 33 include the rule that the switch from an asset's replacement cost to its lower recoverable amount should only be made 'if a permanent diminution to below net current replacement cost has been recognized' (or 'if it is judged to be materially and permanently lower' than its current cost). The position taken by the TO in the Netherlands would seem preferable; that is that a downward revaluation of fixed assets should only be made in the case of a decision taken by the management to discontinue the relating activities. As long as such a decision has not been taken, depreciation on a replacement cost basis is an indispensable condition for the correct measurement of results of continuation of activities and, in many instances, for the proper measurement of its losses.

A further harmonisation of existing national differences is becoming more and more important; greater uniformity is in the interest of international business and finance.

Notes
This Congresspaper is an adaptation of an article in MAB 1981 page 270.

Appendix

The following lists principal accounting proposals in various countries:

Argentina

Consejo Profesional de Ciencias Economicas de la Capital Federal, Resoluciones 25/76, 105/76, 99/78, 183/79. Buenos Aires, Argentina. (1980)

Comision Nacional de Valores, Republica Argentina, Resolucion general Nro. 59

Australia

Provisional Standard: Current Cost Accounting (Institute of Chartered Accountants in Australia and Australian Society of Accountants) PAS 1.1 (issued 1976, revised 1978)

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